No. 80-2092

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

SCM CORPORATION,

Petitioner,

—v.—

XEROX CORPORATION,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

RESPONDENT'S BRIEF IN OPPOSITION

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COUNTERSTATEMENT OF QUESTION PRESENTED

Did the court of appeals correctly hold that the antitrust laws do not prohibit a company with no market power whatsoever from acquiring valid patents from a non-competitor research organization at a time prior to the commercialization of the patented inventions and long before the advent of a relevant product market when, years after the acquisition, the acquiring company develops a product embodying the patented art, a relevant market embracing that product comes into existence and, by virtue of the acquired patents and other valid patents covering the acquiring company's own inventions, the company achieves monopoly power in that market?*

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* Pursuant to Supreme Court Rule 28.1, Xerox, a New York corporation, states that it has no parent or affiliates. Xerox has one United States subsidiary which is not wholly owned—Rank Xerox Business Equipment, Inc., a Delaware corporation. Xerox also has other subsidiaries, as defined by the Securities and Exchange Commission, in a number of foreign countries: Xerox do Brasil, S.A.; Xerox de Mexico, S.A. de C.V.; Xerox del Peru, S.A.; Xerox de Venezuela, C.A.; Xerox de Colombia, S.A.; Rank Xerox Limited; Rank Xerox Holding B.V.; Rank Xerox Manufacturing (Nederland) B.V.; Rank Xerox Fabrikations G.m.b.H.; Societe Industrielle Rank Xerox S.A.; Fuji Xerox Co., Ltd.; Office de Transformation Papetiere S.A.; Rank Xerox Espanola S.A.; Rank Xerox (N.Z.) Ltd.; and Rank Xerox (Australia) Pty. Ltd.

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RESPONDENT'S BRIEF IN OPPOSITION

The Petition does not present any issue warranting review by this Court. This case concerns the application of the antitrust laws to a unique set of circumstances highly unlikely to recur: the acquisition of concededly valid patents from a non-competitor research organization prior to the commercialization of the patents into a new product—where the research organization and the original inventor have previously tried in vain for years to persuade others to invest in the development of the invention; where the company that ultimately acquires the patents sponsors further work at the research organization and itself simultaneously engages in costly and important research and development leading to patentable discoveries and ultimate commercialization of the invention; where the acquisition takes

place years before the product is developed; where more years elapse before a relevant market comes into being; and where the product eventually revolutionizes the market, so that the acquiring company, by virtue of its patent protection, achieves monopoly power.

Not only is there no reason to believe that a case involving such an extraordinary congeries of facts will arise in the future, but the court of appeals was eminently correct in holding that there was no antitrust violation on those facts. For a patent acquisition made by a company with no market power whatsoever, four years before it commercializes the patented technology and at least eight years before the evolution of a relevant market, cannot violate the antitrust laws without subverting the patent system and its underlying public policy of stimulating invention—a policy which "runs no less deep" than the policy of free competition reflected in the antitrust laws. *Dawson Chemical Co.* v. *Rohm & Haas Co.*, 448 U.S. 176, 221 (1980).

STATEMENT OF THE CASE

This case involves the antitrust legality of Xerox' 1956 acquisition of patents covering xerography, a process ultimately embodied in the first plain paper office copier, which entered the marketplace four years later in 1960 after an intensive thirteen-year research and development effort. The product proved to be a great commercial success—so much so that the jury found that, by 1969, it constituted its own economic submarket in which Xerox possessed monopoly power by virtue of the exclusionary force of the acquired patents and other patents covering Xerox' own inventions. Petitioner commenced this treble-damage suit because Xerox declined to license those patents for plain paper copying. As a result of the jury's verdicts, at this juncture petitioner's claim rests solely on the proposition that the 1956 acquisition was an act of monopolization, a contract in unreasonable restraint of trade and an unlawful asset acquisition—all assessed in a

relevant market that did not exist as late as 1964 but had emerged by 1969.[1] The court of appeals held that the challenged patent acquisition by a company devoid of market power—four years before the introduction of the first plain paper copier and at least eight years prior to the advent of a relevant market—was lawful when it was made and did not become unlawful by the passage of time.

THE FACTS

The Petition presents a warped and incomplete picture of the salient facts. Those facts, in brief summary, are as follows:

Chester Carlson invented the xerographic process in the late 1930's and was awarded four patents covering his invention (E 2867-68; E 3433; E 709-46; A 734-35).[2] As originally practiced by Carlson, the process was extremely crude and limited to the laboratory (E 3415-26). From 1940 through 1944, the inventor unsuccessfully approached 18 separate companies in an effort to interest a commercial enterprise in making the investment needed to develop the process into a marketable product (A 2523-24; E 3431). IBM alone rejected Carlson's offer "on three separate occasions, two of which involved an offer by Carlson to sell exclusive rights to all of his patents" (PA 5a; A 2520-22; E 3432).

The first company to evince any interest in xerography was Battelle Memorial Institute ("Battelle"), a non-profit research

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1 As the court of appeals explained, "[t]he relevant product market, which SCM claimed Xerox monopolized by 1964, allegedly consisted only of plain- and coated-paper copiers, and was described as the convenience office copier market. SCM also argued that plain-paper copiers by 1964 formed a relevant submarket over which Xerox acquired monopoly control. Xerox on the other hand argued that the relevant product market included offset, spirit, and mimeograph equipment. In any event, the jury found the markets suggested by SCM existed in 1969 but *not* in 1964" (PA 8a n.1; emphasis by the court).

2 Citations to the record conform to the form set forth in the Petition, p. 1 n.1.

organization "in the business of developing and improving technical inventions and in selling the rights thereon when patented . . ." (PA 5a; E 211). In 1944, Carlson granted Battelle an exclusive license (followed, ultimately, by a formal assignment) of his patents and designated Battelle his exclusive licensing agent (E 212-13).

Battelle continued to do laboratory work on the process and made a number of patented improvements. But since Battelle had never manufactured or marketed any product and did not contemplate doing so with xerography, it was still necessary to find a commercial investor. Between 1944 and 1947 Carlson and Battelle approached 36 companies, including IBM for the fourth time (PA 5a; E 3434-35; E 2180-99; E 3608-12; E 1485; A 2520-22; A 2717-18); but none was willing to risk the necessary time, money and effort on what was still a primitive laboratory process which required so much light and took so long to reproduce an image that commercial exploitation was not feasible (E 2896-97; E 1417; A 2525-27; A 2717-18; A 2535; A 2538).

Finally, The Haloid Company (now Xerox), a small, marginally profitable manufacturer of photographic equipment and supplies with limited capital and a speculative future, contacted Battelle and sought rights in xerography (A 858-62; A 3461-62; E 149-52; E 679-80; E 3430; A 2518-19; E 3408-09; A 2528-31). In January, 1947 Battelle granted Xerox a non-exclusive license (which, under certain conditions, would become exclusive) under all existing and future United States xerographic patents obtained by Carlson and Battelle. In return, Xerox agreed to (a) pay a royalty; (b) sponsor further research at Battelle; and (c) grant back to Battelle royalty-free rights to any xerographic patents resulting from Xerox' work or under its sponsorship (E 181-93; E 233-35). In 1948, Xerox' license became exclusive; Xerox agreed to "use diligent efforts to secure sublicensees to engage in research, development and commercialization of the inventions and patents"; and Xerox undertook to grant back to Battelle title to any xerographic

patents Xerox might obtain on its own inventions or on work it sponsored at Battelle (E 474-88).[3]

Commencing in 1947, Xerox and Battelle worked together to develop the rudimentary process so that it could be embodied in a xerographic copier and other commercial products. This was a massive task, given the complex nature of the process and the need to develop new technology to implement each step (A 2578-89; A 2600). Both companies made significant patented inventions, and there were numerous technical exchanges between them (E 208; E 1424-25; A 2818-19). By 1950 the joint development effort resulted in the first commercial product utilizing xerography—the "flat plate" machine (E 1493);[4] and in the middle 1950's Xerox introduced its second xerographic product—the "Copyflo".[5] SCM conceded below that neither product "found commercial acceptance as convenience office copiers, the product market that SCM claims Xerox dominated for over a decade" (PA 7a; *see also* PA 74a n.30).

In 1956, after nine years of joint Xerox-Battelle effort in developing xerography, Xerox acquired title to the basic Carlson patents; an unrestricted exclusive license under the Carlson and Battelle improvement patents with the right to their assignment in January, 1959; and the right to assignment of all future Battelle xerographic patents so long as Xerox spent at least $25,000 a year sponsoring xerographic research

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3 In 1951, the license was extended to include rights in foreign countries (E 495-96).

4 The "flat plate" machine, which consisted of a number of separate units, required 20 manual steps and three or four minutes to produce one copy of a single page (A 2567-70; A 897-98). Its cumbersomeness and slowness rendered it a failure as a copier, but it did achieve some market acceptability as a means for preparing paper masters for use with offset equipment (A 897-98; A 2571-73; A 2576-77).

5 The "Copyflo"—which was 7 feet high, 5 feet wide and 3 feet deep and weighed approximately 1 ton (A 2687)—made copies from a roll of microfilm onto a roll of paper. It was totally impractical as a copier (A 2685-86; A 3309-11).

at Battelle. In exchange, Battelle received 55,000 shares of Xerox stock and a cash payment commencing in 1959 and terminating in 1965 measured by a percentage of Xerox' sales (E 334-42). A fundamental motivation for the acquisition was the beneficial cash-flow effect produced by the amortization of the patents on Xerox' books, which freed additional funds for further research and development (A 934-35; E 2051-53).[6] In 1956, when the acquisition was made,[7] there was no plain paper copier;[8] there was no relevant market comprising convenience office copiers, let alone plain paper copiers (neither market would come into existence until some time after January, 1964); and Xerox had no market power whatsoever.

It was not until 1960, after overcoming a host of technological problems, that Xerox succeeded in developing and introducing the first plain paper copier—the 914. Even as late as 1959, however, the new product's success was far from a sure thing. Xerox had invited IBM to examine prototypes of the 914 and the smaller desk-top 813, and the world's largest business machine company initially expressed some interest in the possibility of working together with Xerox in the manufacture and marketing of the two machines (A 3551-52). But in early 1959, IBM rejected the proposition because its management consultant, Arthur D. Little & Co., had concluded that the 914 had "no future" and the 813 was "not a good business risk" (E

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6 Petitioner's statement (Petition, p. 21) that "[t]he 1956 Agreement had nothing to do with investment incentives" is therefore incorrect.

7 As the court of appeals recognized, while the Battelle improvement patents were not transferred to Xerox until January, 1959, that event "was a mere formality." Since Xerox obtained an unrestricted exclusive license in 1956, it "acquired the exclusionary power inherent in each of those patents" at that time (PA 32a n.14).

8 Six months earlier, in July, 1955, a Xerox development committee had concluded that the technology to produce such a machine was available and recommended a four-year program of machine design, development and production (A 1331; A 2972-73). Expressing doubt that the potential market for such a machine was "very large," Xerox' Chief Executive nevertheless authorized the program (E 3406; A 2978-79).

3413; E 3411). As the court of appeals pointedly noted, "at the very least the episode demonstrates that as of 1958 the achievement of commercial success in plain-paper copying was not a foregone conclusion" (PA 26a).

The 914, which was introduced in 1960, achieved enormous success in the marketplace and was followed in succession by other plain paper copier models.[9] All of these machines were protected by Xerox' patents—those it had acquired from Battelle and numerous others on inventions made by Xerox' own employees. It was Xerox' unilaterally arrived at policy not to license those patents to others for plain paper copying (A 3365-66).[10] As a result, the exclusionary power inherent in the patents conferred monopoly power upon Xerox as of 1969 (by which time, the jury found, the relevant markets asserted by SCM had come into existence).[11]

In stating that "Xerox's monopoly was not based on internally developed technology" (Petition, p. 2), petitioner implies that Xerox occupied the role solely of an investor and was not an inventor. Nothing could be further from the truth. One of petitioner's principal claims at the trial—which the jury

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9 Petitioner's assertion (Petition, p. 6) that Xerox' products were of poor quality is belied by their phenomenal success in the marketplace. *See* Berkey Photo, Inc. v. Eastman Kodak Co., 603 F.2d 263, 286-87 (2d Cir. 1979), *cert. denied*, 444 U.S. 1093 (1980). The trial record is replete with evidence of the high quality of Xerox' products and the market acceptance they received (*e.g.*, A 3273; A 3106-07; A 3113; A 1399).

10 Xerox did, however, license its patents for all other xerographic applications, including coated paper copying (E 3539-40).

11 PA 112a-113a. Petitioner claims (Petition, p. 13 and n.13) that were it not for the entry of a consent order by the Federal Trade Commission in 1975 (pursuant to which Xerox agreed to license its patents), "there would be no other companies marketing plain paper copiers even today." This ignores the fact that IBM introduced a plain paper copier in 1970, and that IBM was followed by 3M (1971), Van Dyk (1971), Litton (1972), Saxon (1972), Addressograph-Multigraph (1973), Remington (1973), Savin (1973), A. B. Dick (1974), Dennison (1974), Canon (1974), Pitney Bowes (1974), and SCM itself (1974)—all prior to the entry of the consent order (E 3336-41).

squarely rejected (PA 118a)—was that by virtue of its own internal efforts Xerox sought to erect an impenetrable "patent thicket"—obtaining a large number of patents for the sake of blocking competitors rather than as a consequence of legitimate efforts to develop new and improved products and to protect its inventions from appropriation or blockage by others. As the court of appeals stated, "[t]he jury's specific finding that by 1969 Xerox had not obtained any patents primarily for the purpose of blocking the development and marketing of competitive products laid to rest any suspicion that either Xerox's internal R&D program or its R&D work subcontracted to Battelle was driven principally by anticompetitive animus" (PA 27a). While the patents acquired from Battelle were highly significant, 28 of the 42 patented inventions embodied in the 914 alone were made by Xerox inventors (E 3592-607); and as of December 31, 1970, 187 of the 220 (expired and unexpired) patents used in Xerox' plain paper copiers covered inventions by Xerox employees (E 3447). In this connection it is noteworthy that what petitioner wanted from Xerox was not simply a license under the Battelle patents, but an across-the-board license covering each and every xerographic patent in Xerox' portfolio (A 1673; A 4229), the overwhelming number of which were internally generated. The short of the matter is that Xerox made a critical contribution to the development of the plain paper copier as an inventor as well as an investor. To quote the court of appeals:

> "Xerox contributed in a very substantial way to the development of an automatic plain-paper copier by investing in research and development not only after 1956 but also for almost a decade before the [1956] agreement" (PA 30a).[12]

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12 From 1947 through 1955, Xerox spent approximately $3 million on xerographic research and development, $547,000 of which involved work sponsored at Battelle (E 3754; A 2114-15; E 2805). From 1956 through 1959, Xerox' expenditures were $6.3 million (E 3754; A 2114); and from 1960 through 1975, Xerox' R&D expenditures on xerography amounted to $761 million (*Id.*).

THE JURY'S VERDICTS

As tried in the district court, this case involved five separate damage claims premised on a variety of alleged antitrust violations (PA 43a-46a). Only two of those claims survived the jury's verdicts, and the Petition seeks review in this Court of only one: the claim that petitioner was unlawfully excluded from the manufacture and marketing of plain paper copiers as of January, 1969 because Xerox refused to grant it a plain paper copying license under its xerographic patents (all of which were assumed to be valid).[13] While petitioner advanced a number of legal theories in support of this claim, the jury's verdicts established, as the court of appeals ruled (PA 13a-14a), that the 1969 exclusion claim cannot be sustained if Xerox' 1956 acquisition of patents from Battelle was lawful. For the jury made a specific finding that the *only* patent-related exclusionary conduct (other than obtaining or exercising lawful patent power) which proximately caused SCM not to enter into plain paper copying was the 1956 Battelle agreement (PA 123a). Since the exclusion claim is premised solely on SCM's failure to obtain a patent license,[14] it follows that only patent-related exclusionary conduct could have caused it to suffer antitrust injury. *Brunswick Corp.* v. *Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 489 (1977).[15] And the jury's verdicts conclusively established that the 1956 Battelle acquisition was the only such conduct by Xerox which the jury believed violated the antitrust laws.

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13 A 880.

14 To quote the district court, "SCM sought the damages it would have avoided if Xerox had not refused SCM's requests in 1964 and 1969 for plain paper copier patent licenses. . . . SCM's entire exclusion damage proof consisted of the losses suffered by lack of licenses" (PA 43a, 91a).

15 As the district court observed, "SCM cannot predicate damage liability on any non-patent-related conduct because it neither claimed nor offered evidence that any such conduct, the post-employment covenants, for example, caused it any damage" (PA 90a-91a). *See also* PA 16a-17a.

Without ruling on Xerox' objection that the 1956 acquisition was lawful as a matter of law (A 4226-28), the district court submitted the legality of that transaction to the jury. This procedure accorded with the court's desire to submit all material issues to the jury in order to maximize fact finding, even though the court had "grave doubts as to several of SCM's theories" (PA 59a).[16] The jury found that the acquisition violated both Section 7 of the Clayton Act[17] and Section 1 of the Sherman Act.[18] Consonant with the district court's instruction (A 477) that if the 1956 agreement violated either of those statutes, Xerox willfully acquired monopoly power in violation of Section 2 of the Sherman Act,[19] the jury made that finding as well.[20] It went on to determine that, if SCM had entered into plain paper copying in January, 1969, it would have earned cumulative profits amounting to $11.5 million and would have had a going concern value of $25.6 million by the end of 1976 (PA 125a-26a).[21]

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16 *See also* A 4383. *Cf.* Broadway Delivery Corp. v. United Parcel Serv. of America, Inc., 1981-1 Trade Cas. ¶ 64,068 at p. 76,471 n.6 (2d Cir. 1981).

17 15 U.S.C. § 18.

18 15 U.S.C. § 1.

19 15 U.S.C. § 2.

20 On the other hand, the jury found that Xerox did not have a specific intent to monopolize, thereby rejecting SCM's charges of attempt and conspiracy to monopolize (PA 119a, 120a); it found that Xerox had not conspired with Battelle or with Xerox' foreign affiliates to deny plain paper copying licenses or to exclude other companies from plain paper copying (PA 113a, 114a, 121a, 122a); and it found that Xerox did not obtain patents on its own inventions primarily for the purpose of blocking the development and marketing of competitive products (PA 118a).

21 Both in the district court and the court of appeals Xerox contended that SCM's damage theory was so speculative that it should not have been submitted to the jury; and that, in any event, SCM was not entitled to recover for its alleged loss of going concern value. Neither court found it necessary to reach these issues. The district court noted, however, that it had "the most serious doubts as to whether the damage profile survives the *Bigelow* standard" (A 4212, citing Bigelow v. RKO Radio Pictures, Inc., 327 U.S. 251 (1946)), and that "the net going concern value claim was of exceedingly doubtful validity" (PA 47a n.12).

THE DECISIONS BELOW

Following the jury's verdicts, the district court addressed the legal issue of whether SCM was entitled to the entry of a damage judgment. Leaving for a later day the question of whether equitable relief might be available, the court concluded that Xerox was not liable to SCM for any money damages. While intimating that Xerox' 1956 patent acquisition did not violate the antitrust laws,[22] the court found it unnecessary to reach that question, holding that in no event could Xerox' unilateral refusal to license its patents under the circumstances of this case give rise to damage liability.

The Court of Appeals for the Second Circuit, exercising its discretion to entertain petitioner's interlocutory appeal pursuant to 28 U.S.C. § 1292(b), affirmed, holding that (a) in light of the jury's findings, SCM's 1969 exclusion claim could be sustained only if the 1956 Battelle patent acquisition violated the antitrust laws; and (b) the acquisition did *not* violate those laws.

The court of appeals labored under no illusion that all patent acquisitions are immune from the antitrust laws.[23] But it noted that, in assessing the legality of a patent acquisition, "the focus should be upon the market power that will be conferred by the patent *in relation* to the market position then occupied by the acquiring party" (PA 28a; emphasis by the court). Agreeing with Professors Areeda and Turner, the court stated that "whether limitations should be imposed on the patent rights of an acquiring party should be dictated by the extent of the power already possessed by that party in the relevant market

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22 "It is highly questionable whether a § 7 violation occurs at all when a company acquires patents prior to the existence of a relevant product market or acquires patents at a time when it has no market power in a relevant product market" (PA 74a).

23 "Patent *acquisitions* are not immune from the antitrust laws" (PA 22a; emphasis by the court).

into which the products embodying the patented art enter" (PA 28a, citing P. AREEDA & D. TURNER, ANTITRUST LAW: AN ANALYSIS OF ANTITRUST PRINCIPLES AND THEIR APPLICATION ¶ 819 (1978)). That being so, it was apparent to the court that the 1956 Battelle acquisition was dramatically different from the acquisition of a patent that substantially augments an existing competitor's market share (PA 22a).[24] "[T]he patents . . . were acquired in 1956, four years prior to the production of the 914, Xerox's first automatic plain-paper copier, and at least eight years prior to the appearance of the relevant market and submarket" (PA 25a). In such circumstances, the court held, "to impose antitrust liability upon Xerox would severely trample upon the incentives provided by our patent laws and thus undermine the entire patent system" (PA 30a). As for petitioner's argument that, under *United States* v. *E. I. du Pont de Nemours & Co.*, 353 U.S. 586 (1957), Xerox' continued "holding" of the acquired patents violated Section 7 of the Clayton Act in 1969 (13 years after the acquisition), the court ruled that the "holding" doctrine could not sensibly be applied to the lawful acquisition of patents:

> "Where a company has acquired patents lawfully, it must be entitled to hold them free from the threat of antitrust liability for the seventeen years that the patent laws provide. To hold otherwise would unduly trespass upon the policies that underlie the patent law system. The restraint placed upon competition is temporally limited by the term of the patents, and must, in deference to the patent system, be tolerated throughout the duration of the patent grants" (PA 36a).[25]

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24 The court cited as examples of such cases Kobe, Inc. v. Dempsey Pump Co., 198 F.2d 416 (10th Cir.), *cert. denied*, 344 U.S. 837 (1952); and United States v. Besser Mfg. Co., 96 F. Supp. 304 (E.D. Mich. 1951), *aff'd*, 343 U.S. 444 (1952).

25 In light of its holding that the 1956 patent acquisition did not violate the antitrust laws, the court of appeals did not reach a number of other grounds urged by Xerox in support of the district court's judgment, *i.e.*, the evidential insufficiency of SCM's proof on the issue of proximate causation; the impermissively speculative nature of SCM's

REASONS FOR DENYING THE WRIT

I.

THE ISSUE PRESENTED BY THIS CASE IS HIGHLY UNLIKELY TO RECUR AND THUS HAS NO IMPORTANCE TO ANYONE OTHER THAN THE PARTIES

The dispositive issue in this case—the legality under the antitrust laws of Xerox' 1956 patent acquisition from Battelle—arises from the extraordinary history of the invention, development and commercialization of the xerographic process and the plain paper copier. Even a brief recapitulation of the pertinent facts clearly reveals the unique character of the patent acquisition at the heart of this case:

a. Despite years of effort, both the inventor of xerography, Chester Carlson, and his licensee and licensing agent, Battelle, were unable to interest any commercial enterprise in making the investment needed to commercialize the invention;

b. For a decade prior to the acquisition, on a continuing basis, Xerox engaged in costly and valuable research and development—both on its own and by sponsoring further work by Battelle;

c. At the time of the acquisition, Xerox possessed no product in what many years later would become the relevant market, and had no market power whatsoever;

d. Subsequent to the acquisition Xerox continued its developmental efforts and after four years of additional work introduced the first plain paper copier;

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proof of the quantum of its damages; and the legal validity of the jury's finding that SCM's exclusion damages should reasonably have been avoided under the doctrine of avoidable consequences—all of which had also been left unresolved by the district court, since it was unnecessary to reach them.

e. The acquisition was made more than eight years prior to the existence of either relevant market asserted by SCM and found by the jury;

f. At the time of the acquisition—indeed for several years thereafter—the successful development of a commercially acceptable plain paper copier was not a foregone conclusion, as was shown by IBM's rejection of Xerox' new product prototypes in 1959;[26]

g. The patents that Xerox acquired from Battelle, including those sponsored by Xerox, together with numerous patents that Xerox lawfully obtained on its own inventions, turned out to be so significant that the plain paper copiers which were developed to embody their inventions ultimately created a new relevant product market, but not until at least eight (and possibly thirteen) years after the acquisition.

The court of appeals' holding that the 1956 acquisition did not violate the antitrust laws was carefully limited to the peculiar facts of this case[27]—a combination of circumstances

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26 While the jury implicitly found that the future emergence of a plain paper copier submarket at least eight years later was reasonably foreseeable in 1956 (*see* PA 29a n.13), Xerox argued in both lower courts that no reasonable jury could make such a finding. The court of appeals rejected that contention, stating: "While sufficient evidence was presented by Xerox to support a contrary finding, we are unable to hold, as a matter of law, that no rational jury could find that a reasonably foreseeable effect of the 1956 agreement was the eventual acquisition by Xerox of monopoly power in a relevant market" (PA 29a-30a). Nevertheless, IBM's rejection of the 914 and 813 in 1959 clearly supports the court of appeals' further conclusion that Xerox' ultimate success was not preordained (PA 26a).

27 The Second Circuit took pains to make it clear that the disposition of the case turned on its particular facts. Thus, in discussing SCM's claim under Section 2 of the Sherman Act, it wrote: "[W]e conclude that, *under the facts presented here,* the policies of the patent laws preclude the imposition of antitrust liability. . . . We believe that, *under the circumstances presented here,* to impose antitrust liability upon Xerox would severely trample upon the incentives provided by our patent laws and thus undermine the entire patent system" (PA 30a;

which is wholly unprecedented and most unlikely to occur again. Experience teaches that very few patents confer exclusionary power so great as to permit their owner to enjoy an economic monopoly. Ironically, SCM itself, in arguing that concern for investors' incentives did not justify a judgment for Xerox, vigorously asserted in the court of appeals that "very few" patents confer monopoly power.[28] Furthermore, occasions when a patent which does confer monopoly power is acquired from a non-competitor research organization by a company with no relevant product—and, *a fortiori*, no market power—will be even rarer. And such a rare acquisition is even less likely to be made at a time more than eight years before a relevant market comes into existence.

In short, given the "once in a lifetime" facts of this case, it does not offer this Court the opportunity to settle any significant recurring issue under the Sherman Act or the Clayton Act. The dispositive question here is of interest only to the parties. For that reason alone, there is no warrant for review by this Court.

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emphasis supplied). The court's holding under Section 1 was also limited to the particular facts: "Since we have already concluded in our § 2 discussion that *under the facts presented here*, the policies of the patent laws forbid the imposition of antitrust liability irrespective of the jury's implied finding that Xerox's success in plain-paper copying was foreseeable in 1956, SCM's argument under § 1 along these lines must likewise fail" (PA 32a; emphasis supplied). The ruling under Section 7 of the Clayton Act was likewise premised on the special facts of this case: "Where, as here, it is conceded that the relevant product market and submarket did not exist until eight years following the patent acquisitions and that Xerox possessed no power whatsoever in even the inchoate market and submarket until 1960 when it introduced its 914 copier, as a matter of law the 1956 agreement did not violate § 7 at the time it was made" (PA 35a).

28 "[V]ery few patents . . . dominate a substantial economic market . . . . The vast majority of patents carry very little market power" (SCM Br., pp. 122, 125).

II.

THE DECISION OF THE COURT OF APPEALS WAS CORRECT

The legality of Xerox' 1956 acquisition of patents from Battelle flows inexorably from the existence of the patent system and the incentives it provides to inventors and to those who invest in innovation. For this case involves a classic example of how the patent system is supposed to work. Induced by the patent law's offer of exclusive rights to useful inventions, Xerox invested in a thirteen-year pioneering research and development effort which transformed a raw laboratory invention into a revolutionary new product. In holding that the patent acquisition at the heart of this case was not unlawful, the court of appeals was clearly correct, and its decision does not merit consideration by this Court.

The Petition is grounded on a fundamental misconception. It states (pp. 13-14) that this Court "has never ruled that patents confer immunity from the antitrust laws." That is simply not so. This Court has specifically recognized that a valid patent monopoly confers an "exemption from the antitrust laws." *Walker Process Equipment, Inc.* v. *Food Machinery & Chemical Corp.*, 382 U.S. 172, 177 (1965). *See also Precision Instrument Manufacturing Co.* v. *Automotive Maintenance Machinery Co.*, 324 U.S. 806, 816 (1945) (the patent monopoly is an "exception to the general rule against monopolies"); *United States* v. *Aluminum Co. of America*, 148 F.2d 416, 422, 430 (2d Cir. 1945) (Alcoa's original economic monopoly, obtained by virtue of two patent acquisitions, held "lawful"). The reason for this exemption is self-evident. Since the essence of a valid patent is the very power to exclude competition which is anathema to the antitrust laws,[29] one of these two

29 As the district court perceptively observed, "[t]he monopoly power condemned by § 2 of the Sherman Act is the power to exclude competition from a relevant market, . . . yet the power to exclude is precisely the power granted by the patent laws" (PA 65a). To quote this Court in Bement v. National Harrow Co., 186 U.S. 70, 91 (1902), "[t]he very object of these [patent] laws is monopoly."

complementary public policies must give way to accommodate the other. The only possible accommodation, if we are to maintain a patent system, is to exempt from the antitrust laws the lawful acquisition and enforcement of valid patents—an exemption which is vitally necessary to make the patent system work.

It is axiomatic that the patent system is designed as a stimulus to invention.[30] Equally important is the incentive that patents provide to investors, for without their time, money and effort the public in many cases would not achieve the tangible benefits of the technological innovation the patent laws are designed to stimulate. The court of appeals took note of this critical fact:

> "Investors . . . play a key role, if not an indispensable one today, in both the inventive process and commercialization of inventions. And it is fair to say, we think, that the contribution of the investor in both the funding of research that leads to inventions and the promotion that necessarily must follow to achieve successful commercialization is of comparable value" (PA 23a n.9).[31]

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30 *E.g.*, Kewanee Oil Co. v. Bicron Corp., 416 U.S. 470, 480 (1974) ("The patent laws promote this progress [of science and useful arts] by offering a right of exclusion for a limited period as an incentive to inventors to risk the often enormous costs in terms of time, research, and development"); Sears, Roebuck & Co. v. Stiffel Co., 376 U.S. 225, 229 (1964) ("Patents are not given as favors . . . but are meant to encourage invention by rewarding the inventor with the right, limited to a term of years fixed by the patent, to exclude others from the use of his invention"); Mitchell v. Tilghman, 86 U.S. (19 Wall.) 287, 418 (1874) ("Patent laws have for their leading purpose the encouragement of useful inventions"); Grant v. Raymond, 31 U.S. (6 Pet.) 218, 241-42 (1832) ("It [a patent] is the reward stipulated for the advantages derived by the public for the exertions of the individual, and is intended as a stimulus to those exertions").

31 *See* Picard v. United Aircraft Corp., 128 F.2d 632, 642 (2d Cir.), *cert. denied*, 317 U.S. 651 (1942) (Frank, J., concurring); Mannington Mills, Inc. v. Congoleum Indus., Inc., 610 F.2d 1059, 1070-71 (3d Cir. 1979); F. M. Scherer, Industrial Market Structure and Economic Performance 448 (2d ed. 1980). To quote petitioner's expert witness, "by virtue of having a patent protection, you can usually find investors or people with money, people who have capital or companies who are

Petitioner's contention that Xerox' 1956 acquisition of as yet uncommercialized patents from Battelle violated the antitrust laws totally disregards this incentive to invest. While petitioner argues that patents do not confer any antitrust immunity, it inconsistently acknowledges the existence of an exemption when an inventor "wilfully acquires monopoly power" by securing a patent on his invention. This point was not lost on the court of appeals: "SCM itself admits [that] the procurement of a patent by the inventor will not violate § 2 even where it is likely that the patent monopoly will evolve into an economic monopoly" (PA 23a). But petitioner would not provide the benefit of the exemption to those who invest in inventions patented by others, even though the acquisition does nothing more than transfer a legal monopoly from one person to another without augmenting its economic force.[32]

If the patent system is to work—by providing incentives in the form of limited monopolies to inventors (and, necessarily to investors, if the inventors are to reap their promised rewards)—the antitrust laws cannot be applied to investors lacking any market power who acquire patents prior to their effective commercialization. Otherwise, no one could safely invest in developing a patented invention in the hope of achieving commercial success; for the greater the success, the greater the risk of a finding years later that the antitrust laws had been violated. In the words of the court of appeals, "[t]he

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willing to invest money in taking that baby invention and developing it into a practical commercial device" (A 976-77).

32 Petitioner's analogy (Petition, p. 21) to the distinction sometimes drawn by the antitrust laws between internal growth and expansion by acquisition is a false one. To be sure, a company with, say, ten percent of a relevant market may be permitted to double that share by internal expansion but not by acquiring another ten percent competitor. But the antitrust laws do not prohibit the acquisition by a *non*-competitor (neither actual nor potential) of a company with a twenty percent market share—where the only effect is to put the acquiring company into the shoes of the acquired. *Cf.* United States v. Marine Bancorporation, 418 U.S. 602 (1974). In the case at bar, of course, neither Xerox nor Battelle had *any* share of any relevant market at the time of the acquisition—an *a fortiori* case of legality.

patent system would be seriously undermined . . . were the threat of potential antitrust liability to attach upon the acquisition of a patent at a time prior to the existence of the relevant market and, even more disconcerting, at a time prior to the commercialization of the patented art" (PA 23a). It follows, as the court below held, that the antitrust legality of a patent acquisition must be determined in light of the facts as they existed when the acquisition was made. Assessing Xerox' acquisition on the facts as they existed in 1956, the court of appeals was plainly right in concluding that it fell within the policy of the patent laws and did not violate the antitrust laws.

The stubborn and incontrovertible fact is that the acquisition took place in 1956—four years before the introduction of the first plain paper copier and at least eight years before the advent of a relevant market. Xerox possessed no market power whatsoever in 1956; and it did not acquire any by virtue of its acquisition of the patents. All it obtained was the exclusionary power inherent in the patent grant—power which Xerox could meaningfully exercise only if the inventions eventually became embodied in a successful commercial product. Such power is precisely the reward offered by Congress to inventors and investors in order to stimulate innovation. It rests at the very core of the nation's patent policy. To argue, as petitioner does (Petition, p. 11), that the acquisition would violate the antitrust laws "[w]ere it not for 'the policies of the patent laws' " takes petitioner nowhere, since the patent laws are very much alive and well. What is more, the argument is unsound because the antitrust laws cannot sensibly be construed to prohibit the acquisition of any asset—a patent or anything else—by a company with no market power at a time long before the emergence of a relevant product market; and no court has ever suggested otherwise.[33]

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33 As the district court stated, "there is considerable doubt whether liability can be grounded under § 7 [of the Clayton Act] for the mere acquisition of any asset prior to the existence of a relevant product market" (PA 71a-72a).

Petitioner's contention (Petition, p. 17) that the acquisition was unlawful because it was not "reasonably necessary" to induce further xerographic development is equally untenable. Petitioner argues, in essence, that the acquisition was unnecessary because Xerox already possessed rights to practice the Battelle patents under its 1948 license agreement. In other words, petitioner would penalize Xerox for having spent almost a decade in a continuing research and development effort with Battelle prior to the 1956 acquisition. What is more, petitioner ignores the fact that the 1956 agreement, as Xerox reported to its shareholders at the time, was "vitally important" to the company's financial position because amortization of the patents produced a cash flow of more than $1 million annually—an amount that was "very large in relation to the amount of our profit" (E 2052-53). These additional funds were used by Xerox to further its development of the xerographic process and its application to plain paper copying.[34] Moreover, the legality of a patent acquisition cannot rationally turn on the acquiring company's "need" to obtain exclusive rights; for such a rule would invalidate all exclusive licenses of patents that ultimately confer significant market power (irrespective of the acquiring company's total lack of market power prior to the acquisition), since a non-exclusive license could always be granted to permit the practice of the invention.[35]

Nor does it matter whether Xerox' future commercial success was reasonably foreseeable in 1956. Success certainly was not inevitable. Battelle's 1955 annual report, written con-

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34 Prior to the introduction of the first plain paper copier in 1960, Xerox spent more than twice as much on xerographic research and development after the 1956 patent acquisition than it spent before. *See* p.8, n.12, *supra*.

35 The law does not oblige the would-be possessor of patent rights to bargain for the bare minimum. *See* United States v. Aluminum Co. of America, 148 F.2d 416, 422 (2d Cir. 1945), holding lawful Alcoa's acquisition of exclusive rights to a dominant patent over the objection of the Department of Justice that it could have obtained a non-exclusive license. *See* Brief for the United States at 240; Reply Brief for the United States at 15.

temporaneously with the acquisition, stated that "Carlson's basic patent expires in 1959 and the value of all improvements is an unknown quantity" (E 1475-76). And IBM's 1959 rejection of Xerox' new products as bad business risks with no future amply demonstrates that the future of plain paper copying was debatable. If Xerox was sufficiently prescient to foresee that its development work would bear fruit commercially, that would not be any reason to deprive it of the lawful monopoly provided by the patent system to those willing to take the risk of investing in and commercializing untried inventions.

Also unavailing is petitioner's reliance on the 1956 agreement's termination of Xerox' obligation to seek sublicensees under the Battelle patents. Xerox argued in both lower courts that there was insufficient evidence to support the critical factual predicate for SCM's argument—that absent the acquisition, Battelle would have required Xerox to grant plain paper copying licenses. Indeed, Xerox maintained that the evidence overwhelmingly established that, in the absence of the 1956 agreement, it would have enjoyed the fruits of its exclusive license and continued steadfast in its policy of not licensing others for plain paper copying without any overriding objection from Battelle. For the record stands uncontradicted that on a number of occasions prior to 1956 Xerox denied plain paper copying licenses to others and that Battelle, which was fully aware of Xerox' policy, never disagreed with it or sought to change it (A 1321-22; A 1331-32; A 1172; E 1506; E 1473-74).[36] Neither court found it necessary to reach the issue, but the district court noted that:

> "[S]ignificant issues would arise concerning the statute of limitations and the proper construction of § 7, as well as the issues of evidential sufficiency, if a damage award for profits not earned because of a license refusal could be

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36 This is not surprising since, as early as Battelle's 1949 annual report, it was the research organization's view that office copying was a field "under Haloid's jurisdiction" (A 895-96).

based on the prediction that had Battelle not sold the patents in 1956, it would have required their sub-licensing to SCM in 1969" (PA 75a).

Aside from the issue of evidential insufficiency, even if it were assumed that, absent the acquisition, Battelle would have compelled plain paper copying sublicensing, that would not spell illegality. For every time an important patent is sold or exclusively licensed, the transaction *ipso facto* eliminates anyone who might otherwise have received a license from the original owner.

Still another fallacy of petitioner's argument was exposed by the district court when it pointed out that the claimed sublicensing obligation[37] was superfluous to the legality of Xerox' 1948 and 1951 license agreements: Battelle could lawfully have granted Xerox an exclusive license in 1948 and made it worldwide in 1951 without requiring any sublicensing whatsoever;[38] hence, elimination of that obligation—the existence of which was unnecessary for legality—could not have been unlawful.[39] What is more, even if it were assumed that, absent the 1956

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37 At trial, Xerox contended that Xerox' sublicensing obligation was limited to xerography generally, that is, for xerographic applications other than plain paper copying. While the jury implicitly rejected this argument, Xerox' post-trial motion asserted that there was insufficient evidence to resolve the issue in favor of SCM—a point that neither the district court nor the court of appeals found it necessary to reach (PA 81a).

38 In the words of the district court: "As to embryonic technology, a decade prior to successful commercial application, exclusive patent licenses from a research institute to a commercial developer with no market power in the pertinent field cannot possibly be an unreasonable restraint of trade, even if the developer assumes no obligation to seek sub-licensees" (PA 81a).

39 As the district court put it: "If the 1956 agreement had not been made, Xerox would have incurred no liability under the antitrust laws by refusing to sub-license SCM or anyone else under the Battelle patents. . . . Since Xerox would have incurred no antitrust liability by refusing to sub-license the Battelle patents before 1956, it cannot incur antitrust liability thereafter by entering into a contractual arrangement that confirms its right to refuse to grant licenses" (PA 81a-82a).

agreement, Battelle would have required Xerox to license SCM under the *Battelle* patents, the patents on Xerox' *own* inventions would still have lawfully barred SCM's entry into plain paper copying—thereby breaking the chain of proximate causation requisite to any recovery by petitioner.

As for petitioner's final contention—that even if Xerox' original acquisition of the Battelle patents was lawful in 1956, its continued "holding" of those patents became unlawful under *United States* v. *E. I. du Pont de Nemours & Co.*, 353 U.S. 586 (1957), and *United States* v. *ITT Continental Baking Co.*, 420 U.S. 223 (1975)—the court of appeals was manifestly correct in holding that the doctrine of those cases cannot apply to a patent acquisition that was legal when made. A contrary rule would subject every patent acquisition to the risk that, if the patented invention is ultimately incorporated in a product that, after the passage of time, obtains a substantial share of a relevant market, the acquisition—though initially lawful—would become unlawful. Incentive to invest in the commercial development of innovative technology would be substantially inhibited if the price of success at the end of the road were antitrust liability. So long as such investment is encouraged by the law,[40] it would be counterproductive to apply a "holding" theory to patent acquisitions. Moreover, to invoke the *Dupont-GM* doctrine in a patent context would judicially shorten the 17-year term established by Congress for all patents. It plainly would make no sense to hold that if Chester Carlson had retained his patents—including his improvement patent covering corona charging which the jury found was indispensable to xerographic plain paper copying (PA 117a)—his lawful right to exclude others would have lasted until March, 1969, but that his transfer of those rights to Battelle and then Xerox gave rise to an antitrust violation. The law is not so perverse.

With respect to petitioner's statement (pp. 12, 25) that Xerox possessed monopoly power by virtue of the acquired

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40 This is in sharp contrast to the law's attitude toward corporate mergers which, while not necessarily prohibited, are not affirmatively encouraged.

patents 29 years after the first Carlson patent issued in 1940, thereby implying that Xerox possessed a monopoly for that period, the short answer is that there was no relevant market even as late as January, 1964; hence, Xerox had enjoyed such power for less than five years as of January, 1969.

In the final analysis, the court below correctly decided a unique case. The Petition does not present any issue worthy of review by this Court.

CONCLUSION

For all the foregoing reasons, respondent respectfully submits that the Petition should be denied.

Respectfully submitted,

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July 10, 1981

PROOF OF SERVICE

I, Stanley D. Robinson, attorney for Respondent herein, and a member of the Bar of the Supreme Court of the United States, do hereby certify that on the 10th day of July, 1981, I served copies of the foregoing Respondent's Brief in Opposition to Petition for Writ of Certiorari by delivering same by hand to Gordon B. Spivack, 25 Broadway, New York, New York 10004. I further certify that all parties required to be served have been served.

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